AN OVERVIEW OF FUNDING SOURCES

Property Tax

Background & Definition: Ad valorem property taxes are levied based on a percentage of the fair market value of real property. Since Fiscal Year 1979, following the passage of Proposition 13 in June 1978, the maximum ad valorem property tax in California may not exceed one percent (1.0%) of fair market value. Proposition 13 also limited the growth in assessed valuation by providing that the assessed value may increase at the rate of the Consumer Price Index (CPI), but at a rate not to exceed 2 percent per year based on the 1979 value, unless the property is improved or sold to establish a new market value. The 1% tax rate limit does not apply to indebtedness approved by voters prior to July 1, 1978, and to bonded indebtedness approved by a two-thirds vote after July 1, 1978.

Property Tax revenues, including the 1% levy and other taxes (voter approved debt and special assessments) are collected by the County Tax Collector and allocated among the various taxing agencies including school districts, incorporated cities and various special districts. The taxes are collected according to Tax Rate Areas (TRAs), which are defined geographic areas with uniform tax rates. There are approximately 4,481 TRAs in San Diego County. Currently, the City of San Diego receives approximately 17.1% of the 1% levy collected among the TRAs located within the City. The allocation of the 1% maximum rate among overlapping taxing jurisdictions is subject to State legislative control according to a statutory formula. The basis for allocation under the existing formula is the average tax rate levied by the taxing agency for the three years before Proposition 13 was adopted.

Options to Increase**:** Changing the 1% overall tax would require a State Constitutional amendment (50% Statewide voter-approval). Changing the allocation of the 1% among overlapping jurisdictions could only be accomplished by new legislation at the State level. Local jurisdictions may levy a special ad valorem tax in excess of 1% for the purpose of paying the debt service on debt issuances approved by a two-thirds vote (See Page X for impact on the Property Tax rate from a General Obligation bond issuance in an amount sufficient to yield $200 million in net proceeds).

Sales and Use Taxes

Background & Definition: Sales and use taxes are collected on the total retail price of tangible personal property sold, unless specifically exempted. The State Legislature establishes the tax rate. Effective July 15, 1991, the statewide tax rate became 7.25% (up from 6%). Currently, 0.25% of the State tax rate may be terminated upon certification by the State Director of Finance by November 1 in any year that the balance in the budget reserve for two consecutive years will exceed 4 percent of General Fund revenues. The 0.25% rate can be reinstated if the State Director of Finance subsequently determines that the reserve will not exceed 4 percent of General Fund revenues. One percent of the sales tax collected by the State is collected on behalf of cities (or, for unincorporated areas, on behalf of counties). Allocation of this local component is on the basis of "situs," or the point of sale. State law also allows for local supplemental sales taxes to be approved on a County-wide basis, which is most commonly collected for transportation purposes. A half-cent sales tax for transportation purposes was approved for San Diego County, a portion of which is allocated directly to the City of San Diego. Cities can only levy a supplemental sales tax with special State legislation and with a vote of the local electorate.

The State distributes sales taxes collected within the City as follows:

State General Fund	5.50%
City	**1.00**
County (for transportation)	0.25
Public Safety Augmentation	0.50*
TransNet (local transportation)	0.50
Total	7.75%

*The Public Safety Augmentation tax is collected by the state and allocated among California counties in proportion to each county's share of total taxable sales in the most recent calendar year. The counties are responsible for allocating the funds between the county and the incorporated cities in the county. For San Diego County, the City of San Diego receives approximately 3.18% of the total annual countywide allocation.

Options to Increase: Statewide sales and use taxes could be increased by the Legislature. Additional local sales taxes for special purposes can be levied by counties, up to an aggregate total of 1.0%. As noted above, the county currently has a 0.5% for transportation purposes. Approval of an additional countywide sales tax would require two-thirds voter approval if it were a special tax, and a majority vote if intended to serve as a general tax. Approval of a special Citywide special tax would require special legislation and voter approval (two-thirds special tax and majority vote for general tax).

Possible Fiscal Impact: Based on the City's FY 2002 sales tax revenues of $185.6 million, a 0.25% citywide sales tax increase would generate about $46 million a year. Based on actual FY 2002 revenues collected under the current countywide special ½ cent sales tax for transportation, a countywide ¼ cent sales tax would generate approximately $96 million.

Using the FY 2002 sales tax revenues as a base, an additional sales tax at a rate of 0.0894% would be required to generate $16.6 million in revenues (the amount equivalent to a payment on a Lease Revenue bond generating $200 million in net proceeds). Since, under state law, additional sales taxes may only be levied in some multiple of 0.25%, the actual tax levied would have to be at a rate of 0.125% (1/8th cent). Since a 0.125% special tax would generate additional revenues beyond the debt service requirement, there would have to be some provision for using the surplus within the scope of the uses qualifying the tax as a special tax.

Based on the above FY 2002 estimate for revenues generated by a countywide sales tax, a countywide sales tax sufficient to generate $16.6 million in revenues would be levied at a rate of 0.043%. Given the requirement to levy additional sales taxes at a multiple of 0.25%, the actual tax levied would be at a rate of .0625% (1/16th cent), which would result in revenues beyond the $16.6 million that would have to be expended within the scope of the special tax.

Transient Occupancy Tax

Background & Definition: Also known as a "bed," "room" or "hotel" tax, this tax is imposed on visitors for the privilege of occupying rooms in hotels, motels, inns and other lodging facilities for 30 days or less. Statewide, about 83% of all cities levy this tax. The tax is collected by hotels and other lodging facilities based on a percent of the consumer's total lodging bill, before taxes.

Options to Increase: An increase in TOT would require a two-thirds vote if proceeds were to be used as a special tax, and a majority vote as a general tax. In addition to the voter approval requirements, the City Council has adopted various policies regarding any increase in TOT, including a provision that San Diego's TOT rate not exceed the average rate of 15 designated cities. In 1998, that maximum rate was 13.1%. This policy could be amended by subsequent Council action. Currently, the City's rate of 10.5% is below the rate of most other large cities. Although the City's TOT rate is relatively low, its average room rate is relatively high, ranking seventh highest among the top 25 major markets as of October 2002.

Possible Fiscal Impact: Based on the current FY 2003 budget estimate of $108.2 million based on the current 10.5%, a 1% increase in the TOT would yield approximately $10.3 million. The increase in TOT required to meet the requirement of $16.6 million in annual payments associated with a Lease Revenue bond sufficient to generate $200 million in net proceeds is estimated at 1.6 percent.

In response to a request from the Finance Committee, the following estimates of the impact of TOT at the current 10.5% rate and increased rates of 10.75% and 11.0% by various sizes (as measured by total rooms) were developed, adjusted to reflect estimates of occupancy rates and room rates for establishments located in the City of San Diego.

Estimated Annual TOT Revenue Generated by Hotel Size

Rooms	**Occupancy Rate***	**Room Rate***	**Annual TOT @ 10.5%**	**Annual TOT @ 10.75%**	**Annual TOT @ 11.0%**
150	74%	$119	$505,384	$517,417	$529,450
300	74%	$124	$1,056,712	$1,081,872	$1,107,032
600	74%	$162	$2,756,641	$2,822,275	$2,887,909
800	74%	$184	$4,165,590	$4,264,771	$4,363,952

*Based on estimated average for hotels located in the City during calendar year 2001.

Business License Tax

Background & Definition: A business license tax is a type of excise tax imposed on businesses for the privilege of conducting business within municipal boundaries. State statutes allow for the collection of business license taxes, which are set by local jurisdiction. Most commonly, the tax is based on gross receipts or on the number of employees. Different rates are often set for different kinds of businesses, e.g., manufacturing, retail or service (and even for different kinds of services). Often tax rates reflect a sliding scale depending on business size. Alternative methodologies include flat rate, quantity of goods produced, percentage of payroll, number of vehicles, square footage of the business, or some other combination of factors. San Diego levies a business tax that is based on number of employees, distinguishing between small and larger business. The City charges a flat rate of $34 for a business with less than 12 employees, and $125 plus $5 per employee for larger businesses. City staff estimates that there are 2,000 firms with 13 or more employees in San Diego, with 250,000 affected employees.

Options to Increase: Regulatory fees may be imposed by City Council action. Taxes levied for revenue-raising purposes (which includes San Diego's tax) require two-thirds vote if a special tax, and simple-majority voter approval if a general tax.

Real Property Transfer Tax

Background & Definition: Nearly every city in California levies a Real Property Transfer Tax. Most often, they are so-called "conforming" taxes, whereby a county levies a tax at $1.10 per $1,000 of sales price. Subsequently, a city levies a tax at $0.55 per $1,000. The city tax is credited against the amount of county tax due, with the result that both the city and the county each receive $0.55 per $1,000. Some cities have levied a "non-conforming" tax, at a rate above $0.55 per $1,000. In such cases, there is no credit against the county tax collection. The county receives the full share of the $1.10 per $1,000, and the city receives the amount generated from its own tax rate. The ability of a charter city to levy its own real property sale or transfer tax was challenged and has been confirmed by the State Supreme Court.

Possible Fiscal Impact: Based on FY 2000 receipts, a transfer tax equivalent to that of Sacramento's (at $2.75 per $1,000 the lowest of the non-conforming Peer-Group cities) would gross about $26.5 million, netting about $21.2 million a year in additional revenues after deducting the existing $5.3 million in revenues that would be sacrificed with the adoption of a non-conforming tax. In response to a request from the Finance Committee, information was gathered on the revenue generated by non-conforming property transfer tax rates for other California cities. The following table summarizes these impacts for other large California cities:

Revenue Generated From Non-Conforming Property Transfer Tax

City	Rate (Per $1,000)	*Revenue*	% of General Fund
Oakland	$15.00	$34,358,999	9.3%
San Francisco[1]	6.80	69,881,533	3.8
Los Angeles	4.50	87,000,000	2.1
Sacramento	2.75	4,994,000	2.0
San Jose	3.30	NA	NA

[1]Properties valued under $250,000 pay the total conforming rate of $1.10

Using FY 2001 Property Transfer Tax revenues as a base, the Non-Conforming rate required to generate $16.6 million for annual payments on a Lease Revenue bond issued to provide $200 million in net proceeds (see Page 10) and replace the $5.7 million foregone due to the adoption of a non-conforming rate would be approximately $2.15 per $1,000 ($0.55 to provide for the $5.7 million and $1.60 to provide for the $16.6 million). Since the County would continue to collect a Property Transfer Tax at $1.10 per $1,000, the resulting total Property Transfer Tax rate would be $3.25 per $1,000.

Utility Related Revenue

Utility related revenue includes three separate categories of revenue: (a) utility user taxes that appear directly on the consumers' bills for services; (b) franchise fees or charges that are paid by investor owned utilities for the privilege of using public rights of way and/or conducting their businesses within the boundaries of a municipality; and (c) transfers of income from a municipality's own enterprise operations to the General Fund.

Utility Users Tax
This tax is authorized by State statute and ordinances. Taxes can be levied on electric, gas, cable, television, water and telephone services. (Some city tax structures distinguish between intrastate, interstate, international and wireless telephone services). Statewide, tax rates range form 0.5% to 12.5%. The City does not currently have a Utility Users Tax. Adoption of a Utility Users Tax would require a two-thirds vote if a special tax, and simple-majority voter approval if a general tax.

In response to a request of the Finance Committee, the following table provides information on Utility User taxes levied in other California cities:

Utility User Taxes For Selected California Cities (1)

City	Revenue	Utility Taxed (2)	Rate/Utility User Fee
Sacramento	$42,650,000	E, G, TE, TV	7.50%
Santa Ana	21,790,618	E, G, TE, W	6%, with a cap at $11,000.
Los Angeles	489,419,000	E, G, TE, TV	10.30%
Santa Barbara	8,910,837	E, G, TE, TV, W	6%
Oakland	41,592,000	E, G, R, TE, TV	7.50%
San Jose	53,425,760	E, G, TE, W	5%
San Francisco	56,000,000	E, G, S, TE, W	7.50% Commercial accounts only.
Irvine	2,748,000	E, G, TE	1.5% up to $5K for Commercial/Industrial customers

[1] charged as a percentage of the consumer's utility bill.
[2] E=electricity, G=natural gas, R=refuse collection, S=steam, TE=telephone, TV= cable television, W=water

Possible Fiscal Impact: If a 1% Utility User Tax is applied in the City against electricity, natural gas, cable television, water, and telephone, approximately $18.5 million will be generated which is approximately $15 per capita in revenue.

Franchise Fees

Franchises, which are sometimes characterized as either a fee or a tax, are paid to a municipality from a franchisee as a "rental" or "toll" for the use of city streets and rights-of-way. The City currently has franchise fee agreement with SDG&E based on 3% of gross sales. Under a new agreement with SDG&E, the basic 3% fee was extended, and an additional 4.5% surcharge will be levied on behalf of the City to aid in the under-grounding of overhead electric utility lines. The City also has franchise agreements with the major cable television providers: Cox Cable (5%) and Time Warner (3%). *During Fiscal Year 2002, the City received approximately $39.8 million from SDG&E franchise fees, and $8.1 million from cable television franchise fees.*

Transfers from Municipal Utilities

Cities that operate one or more utilities often transfer funds from their Enterprise Funds to the General Fund in amounts that exceed the direct overhead costs of general government in supporting that utility. Such transfers are most commonly made from municipal power and water enterprises, but are sometimes transferred from wastewater, solid waste, golf, parking and natural gas enterprises.

Beginning in Fiscal Year 1994, in accordance with the City Attorney's opinion that the General Fund has justification for the collection of a reasonable charge from the water and sewer funds as compensation for the benefits resulting from the use of public rights for way for the location of the water distribution and sewage collection system, the City instituted a Right-of-Way charge. This charge was initially based on a fee schedule based on the total lineal feet of water and sewer mains located in the right-of-way. Beginning in Fiscal Year 1996, the right-of-way charge was based on a percent of total operating revenues, consistent with the methodology used by other jurisdictions.

Both Proposition 218 and the Gann Amendment raise legal questions as to the extent such transfers violate "cost of service" restrictions, but there is limited case law on this matter. *During Fiscal Year 2002, transfers from the right-of-way charge totaled $2.3 million.*

Parcel and Other Special Property Taxes

Background & Definition: Parcel taxes are non-ad valorem property taxes, levied for a specific purpose. The most common form of special tax used in California is a tax levied pursuant to the Mello-Roos Community Facilities Act of 1982 (the "Mello-Roos Act"), which authorizes certain public entities to form a Community Facilities District ("CFD"). This method of taxation, as well as benefit assessment districts, has been and would most likely continue to be used by San Diego to create special taxing sub-districts within particular neighborhoods. A City-wide special tax would more likely be implemented under the City's charter powers. Parcel taxes require 2/3rds voter approval. Under the Mello-Roos statute, property owners can approve a parcel tax if there are less than 12 registered voters.

A local tax district may finance the acquisition, construction or improvement of any real or tangible property with an estimated useful life of five or more years. The financed facilities do not need to be located in the district, which allows a parcel tax to finance regional facilities. Most often, parcel taxes are used to service bonds, the proceeds of which finance the improvements. Examples of the types of facilities which may be financed include:

- Local park, recreation, parkway and open space facilities
- Libraries and child care facilities
- Streets and street-related improvements
- Facilities for flood and storm drain protection purposes
- Work to bring buildings to seismic safety standards
- Parcel taxes also may be used to fund certain services, such as:
    - Police and fire protection and ambulance and paramedic services
    - Recreation programs and library services
    - Operation and maintenance of museums and cultural facilities
    - Maintenance of parks, parkways and open space
    - Flood and storm drain protection services
    - Services relating to hazardous substance clean-up

Basis for Collection: Mello-Roos and other parcel taxes are levied on real property and collected on the county property tax bills. The taxes are calculated pursuant to a formula that is established during the formation proceedings and is effectively part of the voter approval. Unlike benefit assessments, there does not have to be a nexus between benefit and the manner in which the taxes are spread. The State Constitution prohibits levying such taxes based on the value of property.

Options to Increase: As previously noted, the levying of a special tax/parcel tax would require a 2/3rds vote. To raise $16.6 million in annual revenues to make payments on a Lease Revenue bond sufficient to generate $200 million in net proceeds, it is estimated that a parcel tax allocated among single family detached units, attached residential units (condominiums, multi-family units and mobile homes), and non-residential (commercial/industrial) units at the following rates would be required:

Initial Parcel Tax Rates as of FY 2003 by Property Type*

Property Type	**Initial Tax Rate**
Single Family Detached	$35.30 per unit
Attached Residential Unit	$18.29 per unit
Commercial/Industrial Unit	$0.061 per sq. ft.

Note that it is assumed that parcel tax rates would decline annually with total annual growth in the number of units.

**The total annual* $16.6 *million tax levy requirement is allocated between residential (detached and attached) and commercial/industrial parcels based on the San Diego County Assessor's 2002 Inventory of Parcels, with 73% allocated to residential uses and 27% to commercial/industrial uses.*

Source: Financing Services, Office of the City Treasurer, City of San Diego